

AUDITING PROCEDURES REPORT

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Local Government Type <input checked="" type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Government Name CITY OF TAWAS CITY	County IOSCO
Audit Date 06/30/2004	Opinion Date 09/23/2004	Date Accountant Report Submitted to State: 12/22/2004	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.


We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ yes ☒ no 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☐ yes ☒ no 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☒ yes ☐ no 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ yes ☒ no 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ yes ☒ no 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ yes ☒ no 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ yes ☒ no 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ yes ☒ no 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ yes ☒ no 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) STEPHENSON, GRACIK & CO., P.C.			
Street Address 325 NEWMAN STREET, PO BOX 592	City EAST TAWAS	State MI	ZIP 48730
Accountant Signature  <div style="float: right; font-size: small;"> Digitally signed by Stephenson, Gracik and Co., P.C. DN: cn=Stephenson, Gracik and Co., P.C., c=US Date: 2004.12.12 09:52:28 -0500 Reason: I am approving this document </div>			



Stephenson Gracik & Co., P.C.

Certified Public Accountants & Consultants

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CITY OF TAWAS CITY
IOSCO COUNTY, MICHIGAN

AUDITORS' REPORT
YEAR ENDED JUNE 30, 2004

AUDITORS' REPORT

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September 23, 2004

Independent Auditors' Report

Members of the City Council
City of Tawas City
Iosco County, Michigan

We have audited the accompanying financial statements of the governmental activities, business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Tawas City, Iosco County, Michigan, as of and for the year ended June 30, 2004, which collectively comprise the City of Tawas City's basic financial statements, as listed in the index. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Tawas City, Iosco County, Michigan, as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 23, 2004, on our consideration of the City of Tawas City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

As described in Note 2, the City of Tawas City has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, *Basic Financial Statements -and Management's Discussion and Analysis-for State and Local Governments*, as of June 30, 2004.

The management's discussion and analysis and budgetary comparison information are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Tawas City's basic financial statements. The combining fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Stephenson, Gracik & Co., P.C.

CITY OF TAWAS CITY

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TAWAS CITY, MICHIGAN

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MANAGEMENT'S DISCUSSION AND ANALYSIS

The discussion and analysis of the City of Tawas City's (the City) financial performance provides an overview of the City's financial activities for the year ended June 30, 2004. The intent of this discussion and analysis is to look at the City's financial performance as a whole. The discussion focuses on the City's primary government and, unless otherwise noted, the component unit reported separately from the primary government is not included. This analysis, a requirement of Governmental Accounting Standards Board Statement 34 (GASB 34), omits certain comparative data that will be available in future years.

Financial Highlights

- The City's assets exceeded its liabilities by \$7,316,574.
- The City's total net assets increased by \$530,557.
- The City's governmental funds reported combined ending fund balance of \$928,484 this year, an increase of \$81,653. Of this amount, \$923,645 is available for spending (*unreserved fund balance*) on behalf of its citizens. The City General Fund 2003/2004 fiscal year end *fund balance* is \$658,266.

Overview of the Financial Statements

The financial statements are organized so the reader can understand the City as a financial whole or as an entire operating entity. The statements also provide a detailed look at specific financial conditions.

The City's basic financial statements are comprised of three components: The government-wide financial statements, fund financial statements, and notes to financial statements. The report also contains other supplementary information in addition to the basic financial statements.

Government-wide Financial Statements

The *statement of net assets* and the *statement of activities* display information about the City as a whole. These statements include the financial activities of the primary government and its component unit except for fiduciary funds. For the most part, the effect of interfund activity has been removed from the statements. The statements distinguish between those activities of the City that are governmental in nature and those that are considered business-type activities. Governmental activities are normally supported by taxes and intergovernmental revenues while business-type activities rely to a significant extent on fees and charges for services.



The statement of net assets presents the financial condition of the governmental and business-type activities of the City at year end. The statement of activities presents a comparison between direct expenses and program revenues for each program or functions of the City's governmental activities and business-type activities. Direct expenses are those that are specifically associated with a service, program, or department and, therefore, clearly identifiable to a particular function.

Program revenues include charges paid by the recipient for the goods or services offered by the program and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues are presented as general revenues of the City with certain limited exceptions. The comparisons of direct expenses with program revenues identifies the extent to which each governmental program or business activity is self-financing or draws from the general revenues of the City.

With this report, capital assets are listed for the City of Tawas City. These assets are comprised of buildings and improvements, machinery and equipment, vehicles, infrastructure, and land owned by the City. These assets total over \$7 million. The City Treasurer performed an inventory and evaluation of assets and categorized a depreciation schedule for assets not fully depreciated.

The City's component unit is comprised of the Tawas City Downtown Development Authority. This component unit is described in the *Notes to the Financial Statements* (page 20). The component unit is separate and may buy, sell, lease, and mortgage property in its own name and can sue or be sued in its own name.

The Tawas City Downtown Development Authority displays assets totaling \$206,365.

Fund Financial Statements

The City uses funds to maintain its financial records during the year. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts. There are three categories of funds:
Governmental, Proprietary and Fiduciary.

Governmental Funds:

Governmental funds are those through which most governmental functions of the City are financed. Governmental fund reporting focuses on the sources, uses and balances of current financial resources. Expendable assets are assigned to the various governmental funds according to the purpose for which they may or must be used. Current liabilities are assigned to the fund from which they will be paid. The difference between governmental fund assets and liabilities is reported as fund balance. The following are the City's major governmental funds:

- General Fund – This fund accounts for all financial resources, except those required to be accounted for in another fund. Revenues are derived primarily from property taxes and state and federal distributions, grants and other intergovernmental revenue.
- Major Street Fund – This fund accounts for the receipt and expenditure of State motor fuel taxes which are earmarked by law (Act 51 PA 1951, as amended) for major street and highway

purposes, Federal aid for major street purposes, and general fund appropriations as well as State Trunkline maintenance contracts.

- Local Street Fund – This fund accounts for the receipt and expenditure of State motor fuel taxes which are earmarked by law (Act 51 PA 1951, as amended) for local street and highway purposes, Federal aid for local street purposes, and general fund appropriations as well as State Trunkline maintenance contracts.

Proprietary Funds:

Proprietary fund reporting focuses on the determination of operating income, changes in net assets, financial position, and cash flows.

The City's enterprise funds may be used to account for any activity for which a fee is charged to external users (citizens) for goods and services. The following are the City's major enterprise funds:

- Sewer Fund – This fund accounts for fees collected for sewer services provided by the City and a city-wide property tax levy.
- Water Fund – This fund accounts for fees collected for water services provided by the City and a city-wide property tax levy.

Fiduciary Funds: Fiduciary fund reporting focuses on net assets and changes in net assets. The City's agency fund accounts for assets held by the City for political subdivisions in which the City acts as fiscal agent for taxes collected and distributed to other political subdivisions.

Notes to Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided on the City *government-wide* and *fund* financial statements. Exhibit J notes 1 – 14; pages 19 through 41 provide an expansive and thorough view of various aspects of the audited financial statements.

Tawas City Downtown Development Authority related financial data is included throughout the notes to financial statements.

Other Information

In addition to the basic financial statements and accompanying notes, this report also presents combining and individual fund statements and schedules.

Government-Wide Financial Analysis

Because this is the first year of implementation of Government Accounting Standards Board Statement No. 34, which requires this new reporting model, the following tables present only current year data. In future years, when prior-year information is available, comparative analysis of government-wide data will be presented.

Summary of Net Assets:

The following summarizes the net assets of the City of Tawas City at June 30, 2004:

	Net Assets Summary		
	<u>Governmental Activities</u>	<u>Business -Type Activities</u>	<u>Total</u>
Current Assets	\$ 987,166	\$ 614,748	\$ 1,601,914
Capital Assets – net	<u>3,078,431</u>	<u>6,034,108</u>	<u>9,112,539</u>
Total Assets	<u>4,065,597</u>	<u>6,648,856</u>	<u>10,714,453</u>
Current Liabilities	58,682	41,488	100,170
Long-Term Liabilities	<u>860,952</u>	<u>2,436,757</u>	<u>3,297,709</u>
Total Liabilities	<u>919,634</u>	<u>2,478,245</u>	<u>3,397,879</u>
Net Assets			
Invested in Capital Assets, Net of Debt	2,502,373	1,507,066	4,009,439
Restricted	4,839	0	4,839
Unrestricted	<u>638,751</u>	<u>2,663,545</u>	<u>3,302,296</u>
Total Net Assets	<u>\$ 3,145,963</u>	<u>\$ 4,170,611</u>	<u>\$ 7,316,574</u>

Summary of Changes in Net Assets:

Following is an analysis of the changes in net assets for fiscal year 2004. Since this is the first year the City has prepared financial statements following GASB Statement No. 34, revenue and expense comparisons to fiscal year 2003 are not available. In future years, when prior year information is available, a comparative analysis of government -wide data will be presented.

Generally speaking, the City's net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for acquisition, construction, or improvement of those assets. The City of Tawas City, through its governing body, i.e., city council, has taken a sensible approach vis-à-vis capital asset acquisition and amortization of the incurred debt. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the City or through external restrictions imposed by creditors, grantors or laws/regulations of other governments.

The City council has prudently set aside funds to offset potential personnel and/or administrative liabilities. It is the City's policy to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

	<u>Governmental Activities</u>	<u>Business -Type Activities</u>	<u>Total</u>
Program Revenues:			
Charges for Services	\$ 194,822	\$ 987,996	\$ 1,182,818
Operating Grants and Contributions	229,370	0	229,370
Capital Grants and Contributions	<u>47,235</u>	<u>0</u>	<u>47,235</u>
Total Program Revenues	<u>471,427</u>	<u>987,996</u>	<u>1,459,423</u>
Program Expenses:			
General Government	236,395	0	236,395
Public Safety	373,962	0	373,962
Public Works	525,267	0	525,267
Community and Economic Development	6,685	0	6,685
Recreation and Cultural	152,195	0	152,195
Payments to Component Unit	58,240	0	58,240
Interest on Long-Term Debt	33,941	0	33,941
Other Expenses	23,135	0	23,135
Water Services	0	482,281	482,281
Sewer Services	<u>0</u>	<u>420,300</u>	<u>420,300</u>
Total Program Expenses	<u>1,409,820</u>	<u>902,581</u>	<u>2,312,401</u>
Net Program Expenses	<u>(938,393)</u>	<u>85,415</u>	<u>(852,978)</u>
General Revenues:			
Property Taxes	731,365	313,159	1,044,524
State Revenue Sharing	217,049	0	217,049
Rent Income	106,873	0	106,873
Investment Earnings and Miscellaneous	10,640	4,449	15,089
Transfers – Internal Activity	<u>17,500</u>	<u>(17,500)</u>	<u>0</u>
Total General Revenues and Transfers	<u>1,083,427</u>	<u>300,108</u>	<u>1,383,535</u>
Change in Net Assets	<u>\$ 145,034</u>	<u>\$ 385,523</u>	<u>\$ 530,557</u>

Governmental Activities

With GASB 34 implementation, this new component of reporting reflects the *Statement of Activities* and illustrates, by department, the expense incurred and revenue received.

Total governmental activities reveal revenues of \$471,427 from *Charges for Services, Operating Grants and Contributions and Capital Grants and Contributions*. The *Charges for Services* are fees for refuse collection, franchises, fire contracts, cemetery sales and openings and penalties. While revenue collected is substantial, operating expenses totaled \$1,409,820 for these same activities. The largest expenses were incurred by General Government offices (\$236,395), Public Safety (\$373,962) and Public Works (\$525,267).

Business-Type Activities

City of Tawas City's *Business-Type activities* are limited to the Sewer and Water Funds.

Financial Analysis of City Funds

As noted earlier in this report, the City uses fund accounting to ensure and demonstrate compliance with finance-related statutory and legal requirements. A thorough review and examination of fund types will reveal the strengths and weaknesses of its daily operations.

Governmental Funds

Governmental funds are those through which most governmental functions of the City are financed. Governmental fund reporting focuses on the sources, uses and balances of current financial resources. The difference between governmental fund assets and liabilities is reported as fund balance. The following are the City's major governmental funds: 1) General fund – accounts for all financial resources, except those required to be accounted for in another fund. Revenues are derived primarily from property taxes and state and federal distributions, grants and other intergovernmental revenue; 2) Major Street Fund – accounts for the receipt and expenditure of State motor fuel taxes which are earmarked by law (Act 51 PA 1951, as amended) for major street and highway purposes, Federal aid for major street purposes, and general fund appropriations as well as State Trunkline maintenance contracts. Local Street Fund – accounts for the receipt and expenditure of State motor fuel taxes which are earmarked by law (Act 51 PA 1951, as amended) for local street and highway purposes, Federal aid for local street purposes, and general fund appropriations as well as State Trunkline maintenance contracts.

This year's City audit, following GASB 34 format, shows 9 funds. These funds are maintained by the City Treasurer as separate units in the General Ledger.

Enterprise Funds

The City's enterprise funds provide the same type of information found in the government-wide financial statements. Commonly, the sewer and water departments comprise these funds. GASB 34 places such funds under the caption of *Propriety Funds* under the appropriate statements, i.e., *Statement of Net Assets*, *Statement of Cash Flows*, etc. More specific detail is seen in Exhibits G, H, and I, pages 16 through 18.

Budgetary Highlights

The City's budgets are prepared according to Michigan law. The most significant budgeted funds are the General, Major Street and Local Street Funds.

During the fiscal year ended June 30, 2004, the City amended the budgets of their major governmental funds a couple of times, none significantly.

General Fund

The General Fund actual revenue was \$1,350,966. That amount is above both the original and final amended budget estimates of \$1,275,240. The variance between the actual revenues, the original budget, and the final budget was the result of increased revenues from various sources.

The actual expenditures of the General Fund were \$1,101,471, which is below the original budget estimates of \$1,155,782 and below the final amended budget of \$1,170,127. The variance between the actual expenditures, the original budget, and the final budget was due to decreased costs in various areas.

The General Fund had total revenues of \$1,350,966 and total expenditures of \$1,101,471 with an ending fund balance of \$658,266.

Major Street Fund

The Major Street Fund actual revenue was \$225,623. That amount is above both the original and final amended budget estimates of \$154,755. The variance between the actual revenues, the original budget, and the final budget was the result of increased revenues from federal grants and various other sources.

The actual expenditures of the Major Street Fund were \$235,119, which is above the original budget estimates of \$185,855 and above the final amended budget of \$195,855. The variance between the actual expenditures, the original budget, and the final budget was due to increased costs of capital outlays.

The Major Street Fund had total revenues of \$225,623 and total expenditures of \$235,119 with an ending fund balance of \$54,857.

Local Street Fund

The Local Street Fund actual revenue was \$49,265. That amount is below both the original and final amended budget estimates of \$50,475. The variance between the actual revenues, the original budget, and the final budget was the result of decreased revenues from various sources.

The actual expenditures of the Local Street Fund were \$85,897, which is below the original budget estimates of \$89,950 and below the final amended budget of \$99,950. The variance between the actual expenditures, the original budget, and the final budget was due to decreased costs in various areas.

The Local Street Fund had total revenues of \$49,265 and total expenditures of \$85,897 with an ending fund balance of \$37,751.

Capital Asset and Debt Administration

Capital Assets

Capital assets are defined by the City as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at *historical cost* or *estimated historical cost* if purchased or constructed. Donated capital assets are recorded at estimated FMV (fair market value) at the date of donation.

The City's infrastructure consists of roads and water/sewer lines. Improvements are capitalized, i.e., depreciated. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized. Interest incurred during the construction of enterprise fund capital assets is also capitalized.

Capital Assets – Governmental Activities beginning balance was \$4,826,799 with an ending balance of \$4,973,611. Governmental Activities Total Capital Assets – Net of Depreciation was \$3,078,431.

Capital Assets - Business Type Activities beginning balance was \$2,718,098 with an ending balance of \$2,775,013. Business-Type Activities Total Capital Assets – Net of Depreciation was \$1,636,331. An expanded and detailed presentation may be seen in Note 7 of the audit, notes to financial statements.

Long-Term Debt

At year's end, long-term debt (due in more than one year) amounted to \$2,893,141. Such debt includes *Due to State of Michigan*, *Notes Payable and Bonds Payable*, as well as *Compensated Absences*. That is, accumulated vested vacation benefits payable and contingent liability for the accumulated sick leave benefits of its employees.

Component Unit

Complete financial statements for the Tawas City Downtown Development Authority may be obtained from the City of Tawas City Clerk's office located at 516 Oak Street, Tawas City, Michigan, 48763.

Requests for Information

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the City of Tawas City Clerk's office located at 516 Oak Street, Tawas City, Michigan, 48763.

CITY OF TAWAS CITY
Iosco County, Michigan

STATEMENT OF NET ASSETS
June 30, 2004

	Primary Government			Component Unit
	Governmental Activities	Business-Type Activities	Total	Downtown Development Authority
<u>Assets</u>				
Cash and cash equivalents (Note 3)	\$ 903,036	\$ 534,256	\$ 1,437,292	\$ 136,365
Investments - real estate	2,570	0	2,570	0
Receivables:				
Special assessments	0	15,551	15,551	0
Accounts, net	14,111	90,005	104,116	0
Due from other governments	33,545	0	33,545	0
Internal balances	25,064	(25,064)	0	0
Prepaid expenses	8,840	0	8,840	0
Investment in Huron Shore Regional Utility Authority (Note 1)	0	1,776,377	1,776,377	0
Investment in Iosco County waste water treatment plant (Note 6)	0	2,621,400	2,621,400	0
Capital assets, net (Note 7)	<u>3,078,431</u>	<u>1,636,331</u>	<u>4,714,762</u>	<u>70,000</u>
Total Assets	<u>4,065,597</u>	<u>6,648,856</u>	<u>10,714,453</u>	<u>206,365</u>
<u>Liabilities</u>				
Accounts payable	52,083	35,148	87,231	0
Accrued liabilities	6,599	6,340	12,939	0
Long-term liabilities:				
Due within one year (Note 8)	72,910	331,658	404,568	0
Due in more than one year (Note 8)	<u>788,042</u>	<u>2,105,099</u>	<u>2,893,141</u>	<u>0</u>
Total Liabilities	<u>919,634</u>	<u>2,478,245</u>	<u>3,397,879</u>	<u>0</u>
<u>Net Assets</u>				
Investment in capital assets, net of related debt	2,502,373	1,507,066	4,009,439	70,000
Restricted for:				
Debt service	10	0	10	0
Perpetual care	4,829	0	4,829	0
Unrestricted	<u>638,751</u>	<u>2,663,545</u>	<u>3,302,296</u>	<u>136,365</u>
Total Net Assets	<u>\$ 3,145,963</u>	<u>\$ 4,170,611</u>	<u>\$ 7,316,574</u>	<u>\$ 206,365</u>

The accompanying notes to financial statements are an integral part of this statement.

CITY OF TAWAS CITY
Iosco County, Michigan
 STATEMENT OF ACTIVITIES
For the Year Ended June 30, 2004

					Net (Expense) Revenue and Changes in Net Assets			
		Program Revenues			Primary Government			Component Unit
Function/Program	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-Type Activities	Total	Downtown Development Authority
Primary Government:								
Governmental activities:								
General government	\$ 236,395	\$ 48,495	\$ 0	\$ 0	\$ (187,900)	\$ 0	\$ (187,900)	
Public safety	373,962	84,049	3,143	0	(286,770)	0	(286,770)	
Public works	525,267	60,188	226,227	47,235	(191,617)	0	(191,617)	
Community and economic development	6,685	0	0	0	(6,685)	0	(6,685)	
Recreation and cultural	152,195	2,090	0	0	(150,105)	0	(150,105)	
Payments to Component Unit	58,240	0	0	0	(58,240)	0	(58,240)	
Interest on long-term debt	33,941	0	0	0	(33,941)	0	(33,941)	
Other expenses	23,135	0	0	0	(23,135)	0	(23,135)	
Total governmental activities	1,409,820	194,822	229,370	47,235	(938,393)	0	(938,393)	
Business-type activities:								
Water services	482,281	484,599	0	0	0	2,318	2,318	
Sewer services	420,300	503,397	0	0	0	83,097	83,097	
Total business-type activities	902,581	987,996	0	0	0	85,415	85,415	
Total primary government	\$ 2,312,401	\$ 1,182,818	\$ 229,370	\$ 47,235	(938,393)	85,415	(852,978)	
Component Units:								
Downtown Development Authority	\$ 11,244	\$ 0	\$ 0	\$ 0				\$ (11,244)
General Revenues:								
Property taxes levied for:								
General operating					731,365	0	731,365	0
Sewer					0	113,214	113,214	0
Water					0	199,945	199,945	0
State revenue sharing					217,049	0	217,049	0
Payments from primary government					0	0	0	58,240
Rent income					106,873	0	106,873	0
Interest and investment earnings					6,603	4,449	11,052	328
Gain on equipment disposal					2,200	0	2,200	0
Other					1,837	0	1,837	0
Transfers - internal activity					17,500	(17,500)	0	0
Total general revenues and transfers					1,083,427	300,108	1,383,535	58,568
Change in net assets					145,034	385,523	530,557	47,324
Net assets - beginning of year, as restated (Note 2)					3,000,929	3,785,088	6,786,017	159,041
Net assets - end of year					\$ 3,145,963	\$ 4,170,611	\$ 7,316,574	\$ 206,365

The accompanying notes to financial statements are an integral part of this statement.

CITY OF TAWAS CITY
Iosco County, Michigan

BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2004

	<u>General</u>	<u>Major Streets</u>	<u>Local Streets</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<u>ASSETS</u>					
Cash and cash equivalents (Note 3)	\$ 636,699	\$ 42,339	\$ 50,391	\$ 173,607	\$ 903,036
Investments - real estate	0	0	0	2,570	2,570
Receivables:					
Accounts	14,111	0	0	0	14,111
Due from state	0	25,183	8,362	0	33,545
Due from other funds (Note 4)	40,684	0	0	1,438	42,122
Prepaid expenses	<u>8,840</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>8,840</u>
Total Assets	<u>\$ 700,334</u>	<u>\$ 67,522</u>	<u>\$ 58,753</u>	<u>\$ 177,615</u>	<u>\$ 1,004,224</u>
<u>LIABILITIES AND FUND EQUITY</u>					
Liabilities:					
Accounts payable	\$ 34,726	\$ 2,067	\$ 15,290	\$ 0	\$ 52,083
Accrued expenses payable	5,820	468	311	0	6,599
Due to other funds (Note 4)	<u>1,522</u>	<u>10,130</u>	<u>5,401</u>	<u>5</u>	<u>17,058</u>
Total liabilities	<u>42,068</u>	<u>12,665</u>	<u>21,002</u>	<u>5</u>	<u>75,740</u>
<u>Fund Equity</u>					
Fund balances:					
Reserved for:					
Debt service	0	0	0	10	10
Perpetual care	0	0	0	4,829	4,829
Unreserved:					
Designated for budget stabilization	445,092	0	0	0	445,092
Undesignated reported in:					
General Fund	213,174	0	0	0	213,174
Special revenue funds	<u>0</u>	<u>54,857</u>	<u>37,751</u>	<u>172,771</u>	<u>265,379</u>
Total fund equity	<u>658,266</u>	<u>54,857</u>	<u>37,751</u>	<u>177,610</u>	<u>928,484</u>
Total Liabilities and Fund Equity	<u>\$ 700,334</u>	<u>\$ 67,522</u>	<u>\$ 58,753</u>	<u>\$ 177,615</u>	<u>\$ 1,004,224</u>

The accompanying notes to financial statements are an integral part of this statement.

CITY OF TAWAS CITY
Iosco County, Michigan

RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCES TO
 NET ASSETS OF GOVERNMENTAL ACTIVITIES
June 30, 2004

Total governmental fund balances:		\$ 928,484
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported as assets in governmental funds. Capital assets at year end consist of:		
Capital asset cost	\$ 4,973,611	
Capital asset accumulated depreciation	<u>(1,895,180)</u>	
		3,078,431
Long-term liabilities are not due and payable in the current period and, therefore, are not reported as liabilities in the governmental funds. Long-term liabilities at year end consist of:		
Compensated absences payable	(56,678)	
Due to State of Michigan	(250,000)	
Bonds payable	(391,000)	
Notes payable	<u>(163,274)</u>	
Total long-term liabilities		<u>(860,952)</u>
Total net assets - governmental activities		<u>\$ 3,145,963</u>

The accompanying notes to financial statements are an integral part of this statement.

CITY OF TAWAS CITY
Iosco County, Michigan

STATEMENT OF REVENUE, EXPENDITURES AND CHANGES IN FUND BALANCES -
 GOVERNMENTAL FUNDS
For the Year Ended June 30, 2004

	General	Major Streets	Local Streets	Other Governmental Funds	Total Governmental Funds
<u>Revenue</u>					
Current property taxes	\$ 731,365	\$ 0	\$ 0	\$ 0	\$ 731,365
Federal grants	3,143	47,235	0	0	50,378
State grants and revenue	217,049	177,027	49,200	0	443,276
Charges for services	296,641	0	0	0	296,641
Interest and rentals	102,287	160	65	10,964	113,476
Other revenue	481	1,201	0	155	1,837
Total revenue	<u>1,350,966</u>	<u>225,623</u>	<u>49,265</u>	<u>11,119</u>	<u>1,636,973</u>
<u>Expenditures</u>					
Current:					
General government	256,002	0	0	0	256,002
Public safety	319,809	0	0	0	319,809
Public works	358,724	162,527	63,556	0	584,807
Community and economic development	6,685	0	0	0	6,685
Recreation and cultural	85,742	0	0	0	85,742
Other	22,630	0	0	505	23,135
Capital outlay	51,879	72,592	22,341	0	146,812
Debt service:					
Principal	0	0	0	59,847	59,847
Interest and fiscal charges	0	0	0	33,941	33,941
Total expenditures	<u>1,101,471</u>	<u>235,119</u>	<u>85,897</u>	<u>94,293</u>	<u>1,516,780</u>
Excess of revenue over (under) expenditures	<u>249,495</u>	<u>(9,496)</u>	<u>(36,632)</u>	<u>(83,174)</u>	<u>120,193</u>
Other Financing Sources (Uses):					
Sale of fixed assets	0	0	0	2,200	2,200
Operating transfers in	5	0	40,000	58,158	98,163
Transfers from component unit	0	0	0	61,760	61,760
Operating transfers out	(80,658)	0	0	(5)	(80,663)
Transfers to component unit	(120,000)	0	0	0	(120,000)
Total other financing sources (uses)	<u>(200,653)</u>	<u>0</u>	<u>40,000</u>	<u>122,113</u>	<u>(38,540)</u>
Excess of revenue and other sources over (under) expenditures and other uses	48,842	(9,496)	3,368	38,939	81,653
Fund balances - beginning of year	<u>609,424</u>	<u>64,353</u>	<u>34,383</u>	<u>138,671</u>	<u>846,831</u>
Fund balances - end of year	<u>\$ 658,266</u>	<u>\$ 54,857</u>	<u>\$ 37,751</u>	<u>\$ 177,610</u>	<u>\$ 928,484</u>

The accompanying notes to financial statements are an integral part of this statement.

CITY OF TAWAS CITY
Iosco County, Michigan

RECONCILIATION OF THE STATEMENT OF REVENUE, EXPENDITURES AND
 CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
 TO THE STATEMENT OF ACTIVITIES
For the Year Ended June 30, 2004

Total net change in fund balances - governmental funds	\$	81,653
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense.		
Current year depreciation expense	\$ (157,352)	
Capital assets reported as capital outlays in the governmental funds	<u>146,812</u>	
Net difference		(10,540)
Principal repayments on notes are expenditures in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. The amount of repayments reported as expenditures in the governmental funds consist of:		
Notes payable		59,847
Net change in accrued compensated absences:		
Accrued compensated absences June 30, 2003	70,752	
Accrued compensated absences June 30, 2004	<u>(56,678)</u>	
		<u>14,074</u>
Change in net assets of governmental activities	\$	<u>145,034</u>

The accompanying notes to financial statements are an integral part of this statement.

CITY OF TAWAS CITY
Iosco County, Michigan

STATEMENT OF NET ASSETS
 PROPRIETARY FUNDS
June 30, 2004

	Enterprise Funds		
	Major Funds		
	Sewer Fund	Water Fund	Total
<u>Assets</u>			
Cash and cash equivalents	\$ 231,176	\$ 303,080	\$ 534,256
Receivables:			
Special assessments	15,551	0	15,551
Accounts, net	58,173	31,832	90,005
Due from other funds (Note 4)	23	84	107
Investment in Huron Shore Regional Utility Authority	0	1,776,377	1,776,377
Investment in Iosco County waste water treatment plant (Note 6)	2,621,400	0	2,621,400
Capital assets, net	<u>628,416</u>	<u>1,007,915</u>	<u>1,636,331</u>
Total Assets	<u>3,554,739</u>	<u>3,119,288</u>	<u>6,674,027</u>
<u>Liabilities</u>			
Current liabilities:			
Accounts payable	29,888	5,260	35,148
Accrued liabilities	1,664	4,676	6,340
Due to other funds (Note 4)	10,776	14,395	25,171
Contracts payable, current	<u>197,376</u>	<u>134,282</u>	<u>331,658</u>
Total current liabilities	239,704	158,613	398,317
Noncurrent liabilities:			
Contracts payable	<u>1,116,408</u>	<u>988,691</u>	<u>2,105,099</u>
Total Liabilities	<u>1,356,112</u>	<u>1,147,304</u>	<u>2,503,416</u>
<u>Net Assets</u>			
Investment in capital assets, net of related debt	628,416	878,650	1,507,066
Unrestricted	<u>1,570,211</u>	<u>1,093,334</u>	<u>2,663,545</u>
Total Net Assets	<u>\$ 2,198,627</u>	<u>\$ 1,971,984</u>	<u>\$ 4,170,611</u>

The accompanying notes to financial statements are an integral part of this statement.

CITY OF TAWAS CITY
Iosco County, Michigan

STATEMENT OF REVENUE, EXPENSES AND CHANGES IN NET ASSETS
 PROPRIETARY FUNDS
For the Year Ended June 30, 2004

	Enterprise Funds		
	Major Funds		
	Sewer Fund	Water Fund	Total
<u>Operating Revenue</u>			
Charges for services	\$ 491,255	\$ 473,040	\$ 964,295
Service connection charges	4,500	4,900	9,400
Penalties	7,641	6,319	13,960
Miscellaneous	1	340	341
Total operating revenue	<u>503,397</u>	<u>484,599</u>	<u>987,996</u>
<u>Operating Expenses</u>			
Salaries	53,500	77,581	131,081
Fringe benefits	22,460	33,723	56,183
Contracted services	201,268	182,878	384,146
Administrative costs	4,662	2,634	7,296
Insurance	3,000	3,181	6,181
Maintenance	0	54,437	54,437
Equipment rental	10,830	34,534	45,364
System supplies	14,860	0	14,860
Travel and training	0	2,418	2,418
Utilities	11,549	113	11,662
Other	0	675	675
Depreciation	16,818	27,458	44,276
Total operating expenses	<u>338,947</u>	<u>419,632</u>	<u>758,579</u>
Operating income	<u>164,450</u>	<u>64,967</u>	<u>229,417</u>
<u>Non-operating Revenue (Expenses)</u>			
Current property taxes	113,214	199,945	313,159
Interest income	2,701	1,748	4,449
Interest expense and paying agent fees	(81,353)	(62,649)	(144,002)
Total non-operating revenue (expenses)	<u>34,562</u>	<u>139,044</u>	<u>173,606</u>
Income before operating transfers	199,012	204,011	403,023
<u>Other Financing Uses</u>			
Operating transfers out	<u>(17,500)</u>	<u>0</u>	<u>(17,500)</u>
Change in net assets	181,512	204,011	385,523
Net assets - beginning of year, as restated (Note 2)	<u>2,017,115</u>	<u>1,767,973</u>	<u>3,785,088</u>
Net assets - end of year	<u>\$ 2,198,627</u>	<u>\$ 1,971,984</u>	<u>\$ 4,170,611</u>

The accompanying notes to financial statements are an integral part of this statement.

CITY OF TAWAS CITY
Iosco County, Michigan

STATEMENT OF CASH FLOWS
 PROPRIETARY FUNDS
For the Year Ended June 30, 2004

	Enterprise Funds		
	Major Funds		
	Sewer Fund	Water Fund	Total
<u>Cash Flows From Operating Activities</u>			
Receipts from customers	\$ 499,516	\$ 590,873	\$ 1,090,389
Payments for operating expenses	(311,696)	(437,756)	(749,452)
Interest received	2,701	1,748	4,449
Net cash provided by operating activities	<u>190,521</u>	<u>154,865</u>	<u>345,386</u>
<u>Cash Flows From Noncapital Financing Activities</u>			
Property taxes received	113,214	199,945	313,159
Special assessments received	4,214	0	4,214
Cash paid to other funds	<u>(14,574)</u>	<u>(13,761)</u>	<u>(28,335)</u>
Net cash provided by noncapital financing activities	<u>102,854</u>	<u>186,184</u>	<u>289,038</u>
<u>Cash Flows From Capital and Related Financing Activities</u>			
Purchase of capital assets	(8,989)	(47,926)	(56,915)
Reimbursement of capital contribution	0	(5,000)	(5,000)
Principal paid on long-term debt	(197,376)	(123,334)	(320,710)
Interest paid on long-term debt	<u>(81,353)</u>	<u>(62,849)</u>	<u>(144,202)</u>
Net cash used by capital and related financing activities	<u>(287,718)</u>	<u>(239,109)</u>	<u>(526,827)</u>
Net increase in cash and cash equivalents	5,657	101,940	107,597
Cash and cash equivalents at beginning of year (Note 1)	<u>225,519</u>	<u>201,140</u>	<u>426,659</u>
Cash and cash equivalents at end of year (Note 1)	<u>\$ 231,176</u>	<u>\$ 303,080</u>	<u>\$ 534,256</u>
<u>Reconciliation of operating income to net cash provided by operating activities</u>			
Operating income	\$ 164,450	\$ 64,967	\$ 229,417
Adjustments to reconcile operating income to net cash provided by operating activities:			
Interest income	2,701	1,748	4,449
Depreciation expense	16,818	27,458	44,276
Change in assets and liabilities:			
Accounts receivable, net	(3,881)	106,274	102,393
Accounts and other payables	9,594	(44,091)	(34,497)
Accrued expenses	<u>839</u>	<u>(1,491)</u>	<u>(652)</u>
Net cash provided by operating activities	<u>\$ 190,521</u>	<u>\$ 154,865</u>	<u>\$ 345,386</u>

The accompanying notes to financial statements are an integral part of this statement.

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the City of Tawas City conform to accounting principles generally accepted in the United States of America (GAAP) applicable to governmental units. Private-sector standards of accounting issued after November 30, 1989, are generally followed in both the government-wide and enterprise fund financial statements to the extent that those standards do not conflict with the standards of the Governmental Accounting Standards Board. The following is a summary of the significant accounting policies.

A. Description of City Operations and Fund Types

The City of Tawas City was organized in 1885 and covers an area of approximately 1 1/4 square miles. The City operates under an elected City Council (seven members) and provides services to its more than 2,000 residents in many areas, including fire protection, water and sewer services, and maintenance of major and local streets. All activities over which the City exercises oversight responsibility have been included in the reporting entity. Oversight responsibility is determined by factors such as financial interdependency, selection of governing authority, designation of management, ability to significantly influence operations, and accountability for fiscal matters of the entity. On this basis, the financial statements of certain other governmental organizations listed below are not included in the financial statements of the City. Education services are provided to citizens through the local school district which is a separate governmental entity and is not part of this report.

B. Reporting Entity

A reporting entity is composed of the primary government, component units, and other organizations that are included to ensure the financial statements of the City are not misleading. The primary government of the City consists of all funds, departments, board, and agencies that are not legally separate from the City.

Component units are legally separate organizations for which the City is financially accountable. The City is financially accountable for an organization if the City appoints a voting majority of the organization's governing board and (1) the City is able to significantly influence the programs of services performed or provided by the organization; or (2) the City is legally entitled to or can otherwise access the organization's resources; the City is legally obligated or has otherwise assumed the responsibility to finance the deficits of, or provide financial support to, the organization; or the City is obligated for the debt of the organization. Component units may also include organizations for which the City approves the budget, the issuance of debt, or the levying of taxes.

1. Blended Component Unit

Blended component units are separate legal entities that meet the component unit criteria described above and whose governing body is the same or substantially the same as the City Council or the component unit provides services entirely to the City. These component units' funds are blended into those of the City's by appropriate activity type to compose the primary government presentation.

The City of Tawas City Building Authority is legally separate from the City. The Building Authority is reported as if it were part of the primary government because its sole purpose is to finance, construct and maintain buildings, parking facilities and recreation facilities for use for any legitimate public purpose of the City. The financial activities of the City of Tawas City Building Authority are recorded as a governmental activity and a special revenue fund.

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Reporting Entity (Continued)

2. Discretely Presented Component Units

Discretely presented component units are separate legal entities that meet the component unit criteria described above, but do not meet the criteria for blending. The component unit columns on the combined financial statements include the financial data of the City's discretely presented component units. They are reported in separate columns to emphasize that they are legally separate from the City.

The Downtown Development Authority is reported in a separate column to emphasize that it is legally separate from the City. The governing body of this component unit is appointed by the City Council. The Authority was established to eliminate the causes of property value deterioration and promote economic growth in the business district of the City of Tawas City. Complete financial statements for the Tawas City Downtown Development Authority can be obtained from the City of Tawas City Clerk's office located at 516 Oak Street, Tawas City, Michigan, 48763.

C. Joint Ventures

The City of Tawas City has entered into several joint ventures with various municipalities described as follows:

Tawas Police Authority

The Tawas Police Authority functions as a joint venture between the City of Tawas City and the City of East Tawas. The Authority was established to provide police protection to the constituent municipalities, the City of Tawas City and the City of East Tawas, and other municipalities by contract. Each municipality makes contributions based on their share of the adopted annual budget. The City of Tawas City's contribution for the year ended June 30, 2004 was \$229,278. Complete financial statements can be obtained from the City of Tawas City Clerk's office, located at 516 Oak Street, Tawas City, Michigan, 48763.

Tawas Utility Authority

The Tawas Utility Authority was established as a joint venture between the City of Tawas City and the City of East Tawas. The Authority was established for the construction and operation of sewage treatment facilities to service both municipalities. Each municipality makes monthly operation and maintenance payments based on their share of the adopted annual budget. The City of Tawas City's cost for the year ended June 30, 2004 was \$196,576. Complete financial statements can be obtained from the City of East Tawas City Manager's office.

Huron Shore Regional Utility Authority

The Huron Shore Regional Utility Authority was established as a joint venture between the City of Tawas City, City of East Tawas, Charter Township of Oscoda, Charter Township of AuSable, Township of Alabaster, Township of Baldwin, all municipalities in Iosco County, and the Township of Greenbush in Alcona County. The Authority was established to acquire, own, improve, enlarge, extend and operate water supply and distribution systems and sewage disposal systems. The initial contract amount plus any adjustment for the City of Tawas City's share of the contracts is recorded as Investment in Huron Shore Regional Utility Authority in the Water Fund of the City because title to the water and sewer systems belongs to the Authority.

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Joint Ventures (Continued)

Huron Shore Regional Utility Authority (Continued)

The construction was originally funded with the proceeds of the Iosco County Limited Tax General Obligation Bonds dated March 1, 1991. The most current estimate of the City's share is 18.85% of the total bond issue of \$7,930,000 or \$1,494,805. Each entity's percentage of payback will be based on actual gallon usage to be adjusted on an annual basis. The assets of the joint water supply system are the property of the Huron Shore Regional Utility Authority and, therefore, are not presented in these financial statements. The members of this joint venture have pledged their full faith and credit for the payment and are obligated to make such payments from their water funds, including ad-valorem taxes, if necessary. Currently, the City of Tawas City is making payments through ad-valorem taxes and charges for services.

In 1995, the City entered into a joint water and sewer system agreement for the purpose of constructing additions, extensions, improvements and related appurtenances to the Huron Shore Regional Utility Authority Water and Sewer System No. 1, with the Charter Townships of Oscoda and AuSable and the Township of Baldwin. The most current estimate of the City's share is 22.56% of the total bond issue of \$1,300,000 or \$293,280. Each entity's percentage of payback will be based on actual gallon usage to be adjusted on an annual basis. The assets of the joint water supply system are the property of the Huron Shore Regional Utility Authority and, therefore, are not presented in these financial statements. The members of this joint venture have pledged their full faith and credit for the payment and are obligated to make such payments from their water funds, including ad-valorem taxes, if necessary. Currently, the City of Tawas City is making payments through ad-valorem taxes and charges for services. Each municipality makes an annual operation and maintenance contribution based on their proportionate share of the adopted annual budget. The City of Tawas City's contribution for the year ended June 30, 2004 was \$170,056. The current value of the City of Tawas City's investment in the Huron Shore Regional Utility Authority is \$1,776,377. Complete financial statements can be obtained from the Huron Shore Regional Utility Authority's office.

D. Basis of Presentation

The City's basic financial statements consist of government-wide financial statements, including a statement of net assets and a statement of activities, and fund financial statements which provide a more detailed level of financial information.

Government-Wide Financial Statements

The statement of net assets and the statement of activities display information about the City as a whole. These statements include the financial activities of the primary government and its component units except for fiduciary funds. For the most part, the effect of interfund activity has been removed from the statements. The statements distinguish between those activities of the City that are governmental in nature and those that are considered business-type activities. Governmental activities are normally supported by taxes and intergovernmental revenues while business-type activities rely to a significant extent on fees and charges for support.

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. Basis of Presentation (Continued)

The statement of net assets presents the financial condition of the governmental and business-type activities of the City at year end. The statement of activities presents a comparison between direct expenses and program revenues for each program or function of the City's governmental activities and business-type activities. Direct expenses are those that are specifically associated with a service, program, or department and, therefore, clearly identifiable to a particular function. Program revenues include charges paid by the recipient of the goods or services offered by the program and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues are presented as general revenues of the City, with certain limited exceptions. The comparison of direct expenses with program revenues identifies the extent to which each governmental program or business activity is self-financing or draws from the general revenues of the City.

Fund Financial Statements

During the year, the City segregates transactions related to certain City functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. Fund financial statements are designed to present financial information of the City at this more detailed level. The focus of governmental and proprietary fund financial statements is on major funds. Each major fund is presented in a separate column. Nonmajor funds are aggregated and presented in a single column. Fiduciary funds are reported by type, and are excluded from the government-wide financial statements.

E. Fund Accounting

The City uses funds to maintain its financial records during the year. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts. There are three categories of funds: governmental, proprietary and fiduciary.

Governmental Funds

Governmental funds are those through which most governmental functions of the City are financed. Governmental fund reporting focuses on the sources, uses and balances of current financial resources. Expendable assets are assigned to the various governmental funds according to the purpose for which they may or must be used. Current liabilities are assigned to the fund from which they will be paid. The difference between governmental fund assets and liabilities is reported as fund balance. The following are the City's major governmental funds:

General Fund - This fund is used to account for all financial transactions except those required to be accounted for in another fund. The fund includes the general operating expenditures of the local unit. Revenues are derived primarily from property taxes, state and federal distributions, grants, and other intergovernmental revenues.

Special Revenue Funds - These funds are used to account for specific governmental revenue (other than major capital projects) requiring separate accounting because of legal or regulatory provisions or administrative action.

The other governmental funds of the City account for grants and other resources whose use is restricted for a particular purpose; the accumulation of resources for, and the payment of debt; and the acquisition or construction of major capital facilities.

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Fund Accounting (Continued)

Proprietary Funds

Proprietary fund reporting focuses on the determination of operating income, changes in net assets, financial position, and cash flows.

The City's enterprise funds may be used to account for any activity for which a fee is charged to external users for goods or services. The following are the City's major enterprise funds:

Sewer Fund – This fund accounts for fees collected for sewer services provided by the City and a city-wide property tax levy.

Water Fund – This fund accounts for fees collected for water services provided by the City and a city-wide property tax levy.

Fiduciary Funds

Fiduciary fund reporting focuses on net assets and changes in net assets. The City's agency fund accounts for assets held by the City for political subdivisions in which the City acts as fiscal agent for taxes, collected and distributed to other political subdivisions.

F. Measurement Focus

Government-Wide Financial Statements

The government-wide financial statements are prepared using a flow of economic resources measurement focus.

All assets and all liabilities associated with the operation of the City are included on the statement of net assets.

Fund Financial Statements

All governmental funds are accounted for using a flow of current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are generally included on the balance sheet. The statement of revenue, expenditures, and changes in fund balance reflects the sources (i.e., revenues and other financial sources) and uses (i.e., expenditures and other financial uses) of current financial resources. This approach differs from the manner in which the governmental activities of the government-wide financial statements are prepared. Governmental fund financial statements, therefore, include a reconciliation with brief explanations to better identify the relationship between the government-wide statements and the fund financial statements for governmental funds.

Like the government-wide financial statements, the enterprise funds are accounted for using a flow of economic resources measurement focus. All assets and all liabilities associated with the operation of these funds are included on the statement of net assets. The statement of changes in revenue, expenses, and changes in fund net assets presents increases (i.e., revenues) and decreases (i.e., expenses) in total net assets. The statement of cash flows reflects how the City finances and meets the cash flow needs of its enterprise activities.

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. Government-wide and enterprise fund financial statements are prepared using the accrual basis of accounting. Governmental funds use the modified accrual basis of accounting; proprietary funds and fiduciary funds use the accrual basis of accounting. Differences in the accrual and modified accrual basis of accounting arise in the recognition of revenue, the recording of deferred revenue, and in the presentation of expenses versus expenditures.

Revenues – Exchange and Nonexchange Transactions

Revenues resulting from exchange transactions, in which each party gives and receives essentially equal value, is recorded on the accrual basis when the exchange takes place. On the modified accrual basis, revenue is recognized in the year in which the resources are measurable and become available. Available means the resources will be collected within the current year or are expected to be collected soon enough thereafter to be used to pay liabilities of the current year. For the City, available means expected to be received within sixty days after year end.

Nonexchange transactions, in which the City receives value without directly giving equal value in return, include property taxes, sales taxes, grants, entitlements, and donations. On the accrual basis, revenue from property taxes is recognized in the year for which the taxes are levied. Revenue from sales taxes is recognized in the period in which the sales are made. Revenue from grants, entitlements, and donations is recognized in the year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the year when use is first permitted; matching requirements, in which the City must provide local resources to be used for a specified purpose; and expenditure requirements, in which the resources are provided to the City on a reimbursement basis. On the modified accrual basis, revenue from nonexchange transactions must also be available before it can be recognized.

Under the modified accrual basis, the following revenue sources are considered both measurable and available at year end: sales taxes, charges for services, fines and forfeitures, state-levied locally shared taxes (including sales tax), grants, interest, and rent.

Deferred Revenues

Deferred revenues arise when assets are recognized before the revenue recognition criteria have been satisfied.

Property taxes for which there was an enforceable legal claim at June 30, 2004, but were levied to finance 2004-2005 operations, have been recorded as deferred revenue. Grants and entitlements received before the eligibility requirements were met have also been recorded as deferred revenue.

On governmental fund financial statements, receivables that were not collected within the available period are recorded as deferred revenue.

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. Basis of Accounting (Continued)

Expenses/Expenditures

On the accrual basis, expenses are recognized at the time they are incurred.

The measurement focus of governmental fund accounting is on decreases in net financial resources (expenditures) rather than expenses. Expenditures are generally recognized in the accounting period in which the related fund liability is incurred, if measurable. Allocations of cost, such as depreciation and amortization, are not recognized in governmental funds.

H. Budgets and Budgetary Accounting

The City normally follows these procedures in establishing the budgetary data reflected in the financial statements.

1. The City Clerk submits to the City Council a proposed operating budget which includes proposed expenditures and the means of financing them.
2. A public hearing is conducted to obtain taxpayer comments.
3. Prior to July 1, the budget is legally enacted through passage of an ordinance.

All budget appropriations lapse at year end. Budgetary amounts reported herein are as originally adopted, or as amended by the City Council.

The City adopts budgets for the General Fund and Special Revenue Funds.

The budgets of the City are prepared on the same basis of accounting as the financial statement presentation. The budgets were adopted at the activity level.

The legal level of control is at the activity level for the General Fund, and at fund expenditure totals for the Special Revenue Funds.

Revisions that alter the total expenditures of any fund or total department expenditures must be approved by the City Council. The financial statements include budgetary amounts as amended.

I. Cash and Cash Equivalents

For presentation on the financial statements, investments in cash management pools and investments with an original maturity of three months or less at the time they are purchased by the City are considered to be cash equivalents. Investments with an initial maturity of more than three months are reported as investments.

Investments are reported at fair value, except for repurchase agreements and certificates of deposit which are reported at cost. Fair value is based on quoted market prices. Mutual funds are reported at current share price.

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

J. Receivables

Receivables at June 30, 2004, consist of accounts (fees) and special assessments. All receivables are net of estimated uncollectible accounts. Receivables are recognized to the extent the amounts are determined material and substantiated, not only by supporting documentation but also by a reasonable systematic method of determining their existence, completeness, valuation, and collectibility.

The balances consist primarily of charges for sewer and water services due from various customers.

K. Interfund Receivables and Payables

On the fund financial statements, receivables and payables resulting from short-term interfund loans or interfund services provided and used are classified as "interfund receivables/payables". Interfund balances within governmental activities and within business-type activities are eliminated on the government-wide statement of net assets. The only interfund balances which remain on the government-wide statement of net assets are those between governmental and business-type activities. These amounts are reflected as "Internal Balances".

L. Prepaid Items

Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid items in both the governmental-wide and fund financial statements.

M. Inventories

Inventories have not been recognized in the financial statements as they are not material and have been expensed when purchased.

N. Capital Assets

General capital assets are capital assets which are associated with and generally arise from governmental activities. They generally result from expenditures in governmental funds. General capital assets are reported in the governmental activities column of the government-wide statement of net assets, but are not reported in the fund financial statements. Capital assets used by the enterprise funds are reported in both the business-type activities column of the government-wide statement of net assets and in the respective funds.

Capital assets are defined by the government as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The City's infrastructure consists of roads, bridges, dams, and water and sewer lines. Improvements are capitalized. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized. Interest incurred during the construction of enterprise fund capital assets is also capitalized.

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

N. Capital Assets (Continued)

Property, plant and equipment is depreciated using the straight-line method over the following useful lives:

Buildings	40 years
Building Improvements	7 to 40 years
Land Improvements	20 years
Water and Sewer Lines	50 years
Dams	30 - 50 years
Construction Equipment	5 - 10 years
Vehicles	5 - 15 years
Office Equipment	5 years
Computer Equipment	5 years
Firefighting Equipment	10 years
Grounds Equipment	15 years

O. Compensated Absences

Vacation benefits are accrued as a liability as the benefits are earned if the employees' rights to receive compensation are attributable to services already rendered and it is probable the City will compensate the employees for the benefits through paid time off or some other means. The City records a liability for accumulated unused vacation time when earned for all employees with more than one year of service.

Sick leave benefits are accrued as a liability using the vesting method. The liability includes the employees who are currently eligible to receive termination benefits and those the City has identified as probable of receiving payment in the future. The amount is based on accumulated sick leave and employee wage rates at year end taking into consideration limits specified in the City's termination policy. The City records a liability for sick leave earned at varying rates depending on the City policy.

The entire compensated absences liability is reported on the government-wide financial statements.

On governmental fund financial statements, compensated absences are recognized as a liability and expenditure to the extent payments come due each period upon the occurrence of employee resignations and retirements. These amounts are recorded in the account "accrued compensated absences payable" in the fund from which the employees who have accumulated leave as paid. The noncurrent portion of the liability is not reported. For enterprise funds, the entire amount of compensated absences is reported as a fund liability.

P. Accrued Liabilities and Long-Term Obligations

All payables, accrued liabilities and long-term obligations are reported in the government-wide financial statements. All payables, accrued liabilities, and long-term obligations payable from the enterprise fund are reported on the enterprise fund statement. In general, payables and accrued liabilities that will be paid from the governmental funds are reported as a liability in the fund financial statements at the time they are incurred, to the extent that they will be paid from current, expendable, financial resources. However, bonds and other long-term obligations, compensated absences, claims and judgments, contractually required pension contributions and special termination benefits that are paid from governmental funds are recognized as liabilities in the fund financial statements only to the extent that they are due for payment during the current year.

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Q. Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the City or through external restrictions imposed by creditors, grantors or laws or regulations of other governments. The City's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

R. Governmental Fund Balance Reserves

The City reserves those portions of governmental fund balance which are legally segregated for a specific future use or which do not represent available expendable resources and, therefore, are not available for appropriation or expenditure. Fund balance reserves have been established for future debt service and perpetual care expenses.

S. Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the enterprise fund. For the City, these revenues are charges for services for water and sewer usage. Operating expenses are the necessary costs incurred to provide the service that is the primary activity of the fund. Revenues and expenses not meeting these definitions are reported as nonoperating.

T. Extraordinary and Special Items

Extraordinary items are transactions or events that are both unusual in nature and infrequent in occurrence. Special items are transactions or events that are within the control of the Board and that are either unusual in nature or infrequent in occurrence. Neither type of transaction occurred during the current year.

U. Use of Estimates

The process of preparing financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

NOTE 2 - CHANGE IN ACCOUNTING PRINCIPLES AND RESTATEMENT OF FUND EQUITY

A. Change in Accounting Principles

For 2004, the City has implemented Governmental Accounting Standards Board (GASB) Statement Number 33 "Accounting and Financial Reporting for Non-Exchange Transactions," as amended by Statement Number 36 "Recipient Reporting for Certain Shared Non-Exchange Revenue," which establishes standards for recording non-exchange transactions on the modified accrual and accrual basis of accounting; Number 34, "Basic Financial Statements-and Management's Discussion and Analysis-for

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 2 - CHANGE IN ACCOUNTING PRINCIPLES AND RESTATEMENT OF FUND EQUITY

A. Change in Accounting Principles (Continued)

State and Local Governments"; GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus"; GASB Statement No. 38, "Certain Financial Statement Note Disclosures"; and GASB Interpretation No. 6, "Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements".

GASB Statement No. 34 creates new basic financial statements for reporting on the City's financial activities. The financial statements include government-wide financial statements prepared on the accrual basis of accounting and fund financial statements which present information for individual major funds rather than by fund type. Nonmajor funds are aggregated and presented in a single column. Fiduciary funds are reported by type. The government-wide financial statements split the City's programs between governmental activities and business-type activities. The beginning net asset amount for governmental programs reflects the change in fund balance for governmental funds at June 30, 2004, caused by the conversion to the accrual basis of accounting.

GASB Statement No. 37 makes certain clarifications regarding escheat property and modifies several provisions of GASB Statement No. 34, including the Management's Discussion and Analysis. GASB Statement No. 38 modifies, establishes, and rescinds certain financial statement disclosure requirements.

GASB Interpretation No. 6 clarifies the application of standards for modified accrual recognition of certain liabilities and expenditures in areas where differences have arisen, or potentially could arise, in interpretation and practice.

B. Restatement of Fund Equity

The restatement due to the implementation of the above statements and interpretation had the following effects on fund equity of the major Enterprise funds of the City as it was previously reported.

	<u>Sewer Fund</u>	<u>Water Fund</u>
Retained Earnings June 30, 2003	\$ 678,387	\$ 649,239
Restatement of contributed capital in accordance with GASB Statement No. 33	228,488	451,367
Adjustments to investments in other entities to reflect payments reported as expenses in prior years as a result of the adoption of GASB Statement No. 34	<u>1,110,240</u>	<u>667,367</u>
Restated Net Assets – June 30, 2004	<u>\$ 2,017,115</u>	<u>\$ 1,767,973</u>

CITY OF TAWAS CITY
Iosco County, MichiganNOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004NOTE 3 - DEPOSITS AND INVESTMENTS

At year-end, the City's deposits and investments were reported in the basic financial statements in the following categories:

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total Primary Government</u>	<u>Component Unit</u>
Cash and Cash Equivalents	<u>\$ 903,036</u>	<u>\$ 534,256</u>	<u>\$ 1,437,292</u>	<u>\$ 136,365</u>

The breakdown between deposits and investments is as follows:

	<u>Primary Government</u>	<u>Component Unit</u>
Bank Deposits (checking and savings accounts)	\$ 303,064	\$ 136,365
Investments in Municipal Investment Account		
Pooled Funds	1,122,814	0
Petty Cash and Cash on Hand	150	0
Cash with Iosco County	<u>11,264</u>	<u>0</u>
Total	<u>\$ 1,437,292</u>	<u>\$ 136,365</u>

Deposits:

Deposits are carried at cost. Deposits of the City are held at various banks in the name of the City. At June 30, 2004, the carrying amounts of the City's deposits were classified to risk as follows:

	<u>Carrying Amount</u>	<u>Bank Balance</u>
Insured (FDIC)	\$ 164,522	\$ 164,522
Uninsured – uncollateralized	<u>138,542</u>	<u>145,887</u>
Total primary government	<u>\$ 303,064</u>	<u>\$ 310,409</u>

At June 30, 2004, the carrying amounts of the component unit's deposits were classified to risk as follows:

	<u>Carrying Amount</u>	<u>Bank Balance</u>
Insured (FDIC)	\$ 100,000	\$ 100,000
Uninsured – uncollateralized	<u>36,365</u>	<u>36,365</u>
Total component units	<u>\$ 136,365</u>	<u>\$ 136,365</u>

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 3 - DEPOSITS AND INVESTMENTS (CONTINUED)

Investments:

The City Council has adopted an investment policy in accordance with Act 196, PA 1997 which authorizes the City to deposit and invest in the following:

- * Accounts of federally insured banks, credit unions and savings and loan associations
- * Bonds and other direct obligations of the United States or an agency or instrumentality of the United States
- * United States government or federal agency obligation repurchase agreements
- * Banker's acceptances of United States banks
- * Commercial paper rated within the two highest classifications by not less than two standard rating services which matures not more than 270 days after the date of purchase
- * Mutual funds registered under the Investment Company Act of 1940, Title I of Chapter 686, 54 Stat. 789 15 U.S.C. 80a-1 to 80a-3 and 80a-4 to 80a-64 with authority to purchase only investment vehicles that are legal for direct investment by a public corporation

Michigan law requires that public funds may not be deposited in financial institutions that do not maintain an office in Michigan. The City's deposits are in accordance with statutory authority.

The City's investments are categorized to give an indication of the level of risk assumed by the City at June 30, 2004. The categories are described as follows:

Category 1 - Insured or registered, with securities held by the entity or its agent in the entity's name.

Category 2 - Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the entity's name.

Category 3 - Uninsured and unregistered, with securities held by the counterparty, or its trust department or agent but not in the entity's name.

All investments at June 30, 2004 consisted of the following which are not required to be categorized:

	<u>Carrying Amount</u>	<u>Market Value</u>
<u>Nonrisk-Categorized</u>		
Huron Community Bank Municipal Investment Account Pooled Funds	<u>\$ 1,122,814</u>	<u>\$ 1,122,814</u>

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 4 - RECEIVABLES AND PAYABLES WITHIN THE REPORTING ENTITY

The amounts of interfund receivables and payables as of June 30, 2004 were as follows:

<u>Fund</u>	<u>Interfund Receivable</u>	<u>Interfund Payable</u>
Major Governmental Funds:		
General Fund	\$ 40,684	\$ 1,522
Major Street Fund	0	10,130
Local Street Fund	0	5,401
Total Major Governmental Funds	40,684	17,053
Non-major Governmental Funds	1,438	5
Major Enterprise Fund:		
Sewer Fund	23	10,776
Water Fund	84	14,395
	<u>\$ 42,229</u>	<u>\$ 42,229</u>

The amounts of interfund receivables and payables for individual funds as of June 30, 2004 were as follows:

<u>Fund</u>	<u>Interfund Receivable</u>	<u>Fund</u>	<u>Interfund Payable</u>
<u>Primary Government</u>		<u>Primary Government</u>	
General Fund	\$ 10,130	Major Street Fund	\$ 10,130
General Fund	5,401	Local Street Fund	5,401
General Fund	17,073	Water Fund	17,073
General Fund	8,075	Sewer Fund	8,075
General Fund	5	Cemetery Perpetual Care Fund	5
Equipment Fund	1,438	General Fund	1,438
Water Fund	84	General Fund	84
Sewer Fund	23	Water Fund	23
Total	<u>\$ 42,229</u>	Total	<u>\$ 42,229</u>

NOTE 5 - PROPERTY TAXES

Property taxes include amounts levied against all real property and tangible personal property located in the City. Properties are assessed as of December 31 and the related property taxes become a lien on July 1 of the following year. These taxes are due on August 31 with the final collection date of February 28 before they are added to the County tax rolls. For the current year, the taxable value for properties located within the City was \$49,986,112. The tax rates were 13.9671 for operations and 6.2649 for debt retirement.

CITY OF TAWAS CITY
Iosco County, MichiganNOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004NOTE 6 - INVESTMENT IN IOSCO COUNTY WASTEWATER TREATMENT PLANT

The City entered into a joint waste water treatment plant contract with the City of East Tawas through the Iosco County Board of Public Works to refund a portion of the Iosco County Sewer System #3 general obligation bonds dated December 1, 1987. The most current estimate of the City's Share is 61.68% of the total funding bond issue of \$4,250,000 or \$2,621,400. The initial contract amount is recorded as investment in Iosco County Waste Water Treatment Plant in the Sewer Fund of the City because the assets of the joint waste water treatment plant are the property of Iosco County and therefore are not presented in these financial statements.

NOTE 7 - CAPITAL ASSETS

Capital asset activity of the primary government for the current year was as follows:

<u>Government Activities</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital Assets Not Being Depreciated :				
Land	\$ 1,305,324	\$ 0	\$ 0	\$ 1,305,324
Capital Assets Being Depreciated:				
Buildings and Improvements	1,495,754	35,000	0	1,530,754
Land Improvements	868,323	0	0	868,323
Machinery and Equipment	360,330	16,879	0	377,209
Vehicles	797,068	0	0	797,068
Infrastructure - Roads	0	94,933	0	94,933
Subtotal	<u>3,521,475</u>	<u>146,812</u>	<u>0</u>	<u>3,668,287</u>
Less Accumulated Depreciation for:				
Buildings and Improvements	629,864	31,970	0	661,834
Land Improvements	451,558	43,416	0	494,974
Machinery and Equipment	201,083	32,178	0	233,261
Vehicles	455,323	47,415	0	502,738
Infrastructure - Roads	0	2,373	0	2,373
Subtotal	<u>1,737,828</u>	<u>157,352</u>	<u>0</u>	<u>1,895,180</u>
Net Capital Assets Being Depreciated	<u>1,783,647</u>	<u>(10,540)</u>	<u>0</u>	<u>1,773,107</u>
Governmental Activities Total				
Capital Assets—Net of Depreciation	<u>\$ 3,088,971</u>	<u>\$ (10,540)</u>	<u>\$ 0</u>	<u>\$ 3,078,431</u>

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 7 - CAPITAL ASSETS (CONTINUED)

<u>Business-Type</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital Assets Not Being Depreciated :				
Land	\$ 79,700	\$ 0	\$ 0	\$ 79,700
Capital Assets Being Depreciated :				
Buildings	176,878	0	0	176,878
Machinery and Equipment	2,461,520	56,915	0	2,518,435
Subtotal	2,638,398	56,915	0	2,695,313
Less Accumulated Depreciation for:				
Buildings	160,620	2,645	0	163,265
Machinery and Equipment	933,786	41,631	0	975,417
Subtotal	1,094,406	44,276	0	1,138,682
Net Capital Assets Being Depreciated	1,543,992	12,639	0	1,556,631
Business-Type Activities Total				
Capital Assets—Net of Depreciation	\$ 1,623,692	\$ 12,639	\$ 0	\$ 1,636,331

Depreciation expense was charged to programs of the primary government as follows:

Governmental Activities	
General government	\$ 2,464
Public safety	45,275
Public works	42,279
Recreation and cultural	67,334
Total Governmental Activities	\$ 157,352
Business-Type Activities	
Sewer	\$ 16,818
Water	27,458
Total Business-Type Activities	\$ 44,276

Capital asset activity of the Downtown Development Authority for the current year was as follows:

<u>Governmental Activities</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital Assets Not Being Depreciated :				
Land	\$ 70,000	\$ 0	\$ 0	\$ 70,000

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 8 - LONG-TERM DEBT

At June 30, 2004, long-term debt consists of the following individual issues:

	<u>Governmental</u>	<u>Business-Type</u>
<u>Primary government:</u>		
A. Due to State of Michigan:		
\$250,000 loan from the Michigan Department of Commerce which was passed on to the Iosco County Board of Public Works for the construction of a new Waste water treatment system. Program income is to be remitted to the State of Michigan with payback commencing upon notification from the State of Michigan. The amount is to be amortized over 20 years with a balloon payment in one year. Terms are renegotiable at 10 years, however the loan is interest free. As of June 30, 2004, the State of Michigan has not notified the City for commencement of repayment.	\$ 250,000	\$ 0
B. Notes Payable:		
\$220,729 Note Payable to Huron Community Bank for the purchase of a Pierce Sabre Fire Truck. The note is repayable in quarterly installments of \$2,160 including interest at the rate of 4.74% on the unpaid balance.	16,363	0
\$222,350 Note Payable to Huron Community Bank for the purchase of a Pierce Sabre Fire Truck. The note is repayable in quarterly installments of \$5,145 including interest at the rate of 5.3% on the unpaid balance.	146,911	0
	<u>163,274</u>	<u>0</u>
C. Contracts Payable:		
Joint waste water treatment plant with the City of East Tawas through the Iosco County Board of Public Works to refund a portion of the Iosco County Sewer System #3 general obligation bonds dated December 1, 1987, due in annual installments through November 1, 2009, bearing interest at the rates of 4.5% to 5.9%. The most current estimate of the City's share is 61.68% of the total refunding bond issue of \$4,250,000 or \$2,621,400.	0	1,313,784

CITY OF TAWAS CITY
Iosco County, MichiganNOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004NOTE 8 - LONG-TERM DEBT (CONTINUED)

	<u>Governmental</u>	<u>Business-Type</u>
<u>Primary government:</u> (Continued)		
C. Contracts Payable: (Continued)		
Joint water board agreement with the City of East Tawas and Baldwin Township through the Iosco County Board of Public Works to finance the cost of improvements and additions of the water supply system, dated June 28, 1977, due in annual installments through July 1, 2016, bearing interest at the rate of 5%. The most current estimate of the City's share is 25.1% of the total bond issue of \$982,000 or \$246,482.	\$ 0	\$ 129,265
Joint water supply system agreement with the City of East Tawas, the Charter Townships of AuSable and Oscoda, and the Township of Baldwin through the Huron Shore Regional Utility Authority, dated May 1, 1996, due in annual installments through November 1, 2010, bearing interest at the rates of 4% to 5.65% to finance the cost of constructing a new water supply system. The construction was originally funded with the proceeds of the Iosco County Limited Tax General Obligation Bonds dated March 1, 1991. The most current estimate of the City's share is 18.85% of the total bond issue of \$7,930,000 or \$1,494,805.	0	756,828
Joint water supply system agreement with the Charter Townships of AuSable and Oscoda, and the Township of Baldwin to finance the cost of constructing additions, extensions, improvements and related appurtenances to Sewer System No. 1 of the Huron Shores Regional Utility Authority, dated November 1, 1995, due in annual installments through May 1, 2015, bearing interest at the rates of 4.4% to 5.625%. The construction was originally funded with the proceeds of the Limited Tax General Obligation Bonds dated November 5, 1995. The most current estimate of the City's share is 22.56% of the total bond issue of \$1,300,000 or \$293,280.	<u>0</u>	<u>236,880</u>
	<u>0</u>	<u>2,436,757</u>
D. Bond Payable:		
\$535,000 Limited Tax General Obligation Building Authority notes, dated December 1, 1994 used for the purpose of constructing and acquiring recreational facilities and parking improvements in the City of Tawas City. The bonds bear interest from 5.7% to 7% and are due in annual installments through 2009.	<u>391,000</u>	<u>0</u>
Total Primary Government	<u>\$ 804,274</u>	<u>\$ 2,436,757</u>

CITY OF TAWAS CITY
Iosco County, MichiganNOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004NOTE 8 - LONG-TERM DEBT (CONTINUED)E. Compensated Absences

The City has an employee benefit plan that allows employees to accumulate unused vacation hours and also to accumulate sick pay days at the rate of one day per month up to a maximum of 45 days. Upon accumulation of 45 days, full time employees will be paid at the individual's computed hourly rate for each sick day earned in excess of the 45 days not used during the preceding calendar year. This payment will be made every January to those employees who qualify. As of June 30, 2004, the amount of accumulated vacation and sick pay liability for the City is as follows:

	Current Liability <u>6/30/04</u>	Long-Term Liability <u>6/30/04</u>	Total Balance <u>6/30/04</u>
<u>Accrued Employee Benefits Payable</u>			
Primary Government			
Governmental Activities	<u>\$ 1,856</u>	<u>\$ 54,822</u>	<u>\$ 56,678</u>

F. Changes in Long-Term Liabilities

	Balance <u>July 1,</u>	Issues or <u>Additions</u>	Payments or <u>Expenditures</u>	Balance <u>June 30,</u>	Due Within <u>One Year</u>
<u>Governmental Activities</u>					
Primary Government:					
Due to State of Michigan	\$ 250,000	\$ 0	\$ 0	\$ 250,000	\$ 0
Notes payable	183,121	0	19,847	163,274	21,054
Bond payable	431,000	0	40,000	391,000	50,000
Accrued employee benefits payable	<u>70,752</u>	<u>0</u>	<u>14,074*</u>	<u>56,678</u>	<u>1,856</u>
Total primary government	<u>\$ 934,873</u>	<u>\$ 0</u>	<u>\$ 73,921</u>	<u>\$ 860,952</u>	<u>\$ 72,910</u>
<u>Business-Type Activities</u>					
Primary Government:					
Contracts payable	<u>\$ 2,743,317</u>	<u>\$ 0</u>	<u>\$ 306,560</u>	<u>\$ 2,436,757</u>	<u>\$ 331,658</u>

*Represents net of additions and retirements for the year.

CITY OF TAWAS CITY
Iosco County, MichiganNOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004**NOTE 8 - LONG-TERM DEBT (CONTINUED)**

The annual aggregate maturities for all debt outstanding (excluding Due to State of Michigan and compensated absences) as of June 30, 2004 are as follows:

Primary Government**Governmental Activities****Notes Payable**

	<u>Governmental Activities</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 21,054	\$ 8,165	\$ 29,219
2006	22,116	15,183	37,299
2007	14,500	6,080	20,580
2008	15,284	5,297	20,581
2008	16,111	4,470	20,581
2010 – 2013	<u>74,209</u>	<u>8,685</u>	<u>82,894</u>
	<u>\$ 163,274</u>	<u>\$ 47,880</u>	<u>\$ 211,154</u>

Contracts Payable

	<u>Business-Type Activities</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 331,658	\$ 132,195	\$ 463,853
2006	327,191	114,746	441,937
2007	358,968	96,223	455,191
2008	350,915	76,578	427,493
2009	377,790	49,940	427,730
2010 – 2014	628,903	83,122	712,025
2015 – 2017	<u>61,332</u>	<u>3,242</u>	<u>64,574</u>
	<u>\$ 2,436,757</u>	<u>\$ 556,046</u>	<u>\$ 2,992,803</u>

Bond Payable

	<u>Governmental Activities</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 50,000	\$ 21,435	\$ 71,435
2006	50,000	18,463	68,463
2007	51,000	15,420	66,420
2008	56,000	12,162	68,162
2009	56,000	8,737	64,737
2010 – 2014	85,000	16,688	101,688
2015 – 2019	35,000	6,375	41,375
2020	<u>8,000</u>	<u>200</u>	<u>8,200</u>
	<u>\$ 391,000</u>	<u>\$ 99,480</u>	<u>\$ 490,480</u>

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 9 - OPERATING TRANSFERS

During 2004, the following transfers were made:

<u>Description</u>	<u>Operating Transfers In</u>	<u>Operating Transfers Out</u>
<u>Major Funds</u>		
Major Governmental Funds:		
General Fund	\$ 5	\$ 200,658
Local Street Fund	40,000	0
Major Business-Type Activity Funds:		
Sewer Fund	<u>0</u>	<u>17,500</u>
Total Major Funds	40,005	218,158
Nonmajor Governmental Funds	119,918	5
Component Unit:		
Downtown Development Authority	<u>120,000</u>	<u>61,760</u>
	<u>\$ 279,923</u>	<u>\$ 279,923</u>

During 2004, the following individual fund transfers were made:

<u>Fund</u>	<u>Operating Transfers In</u>	<u>Fund</u>	<u>Operating Transfers Out</u>
General Fund	\$ 5	Cemetery Perpetual Care	\$ 5
Local Street Fund	40,000	General Fund	40,000
Equipment Fund	40,658	General Fund	40,658
Equipment Fund	17,500	Sewer Fund	17,500
Building Authority Fund	<u>61,760</u>	Downtown Development Authority	<u>61,760</u>
Total governmental funds	<u>159,923</u>		<u>159,923</u>
Component Unit:			
Downtown Development Authority	<u>120,000</u>	General Fund	<u>120,000</u>
Total	<u>\$ 279,923</u>	Total	<u>\$ 279,923</u>

Transfers are used to move revenues from the fund that statute or budget requires to collect them to the fund that statute or budget requires to expend them and use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

CITY OF TAWAS CITY
Iosco County, MichiganNOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004NOTE 10 - EXCESS OF EXPENDITURES OVER APPROPRIATIONS IN BUDGETARY FUNDS

P.A. 621 of 1978, Section 18(1), as amended, provides that a local unit shall not incur expenditures in excess of the amount appropriated.

In the body of the financial statements, the City's actual expenditures and budgeted expenditures for the budgetary funds have been shown on a functional basis. The approved budgets of the City for these budgetary funds were adopted to the activity level.

During the year ended June 30, 2004, the City incurred expenditures in certain budgetary funds which were in excess of the amounts appropriated as follows:

<u>Fund/Function</u>	<u>Total Appropriations</u>	<u>Amount of Expenditures</u>	<u>Budget Variance</u>
General Fund/Public Safety	\$ 318,269	\$ 319,809	\$ 1,540
General Fund/Operating Transfers Out	\$ 79,220	\$ 80,658	\$ 1,438
Special Revenue Funds/Capital Outlay	\$ 61,476	\$ 94,933	\$ 33,457

NOTE 11 - PENSION PLAN

The City has a defined contribution pension plan covering substantially all its employees. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. The plan is operated through the Farmers New World Life Insurance Company.

As established by the City Council, the City is required to contribute an amount equal to 13% of the earnings of salaried personnel and 8.5% of all other employee's gross earnings.

During the year, the City's required and actual contributions amounted to \$29,917.

No pension provision changes occurred during the year that affected the required contributions to be made by the City or its employees.

NOTE 12 - DEFERRED COMPENSATION PLAN

The City offers to its employees deferred compensation plans created in accordance with Internal Revenue Code (IRC) Section 457. The assets of the plans are held in trust, in a custodial account as described in IRC Section 457 (g) for the exclusive benefit of the participants and their beneficiaries. The custodian thereof for the exclusive benefit of the participants holds the custodial account for the beneficiaries of this Section 457 plan, and the assets may not be diverted to any other use. The administrators are agents of the City for the purposes of providing direction to the custodian of the custodial account from time to time for the investment of the funds held in the account, transfer of assets to or from the account, and all other matters. In accordance with the provisions of GASB Statement No. 32, plan balances and activities are not reflected in the City's financial statements.

CITY OF TAWAS CITY
Iosco County, Michigan

NOTES TO FINANCIAL STATEMENTS
For the Year Ended June 30, 2004

NOTE 13 - NON-CANCELABLE OPERATING LEASE

Tawas City Fire Department

The Tawas City Fire Department leases facilities from the Tawas City Building Authority under a standard lease agreement. Total lease payments for the year ended June 30, 2004 were \$10,425.

NOTE 14 - RISK MANAGEMENT

The City is exposed to various risks of loss related to property loss, torts, errors and omissions, employee injuries, as well as medical benefits provided to employees. The City has purchased commercial insurance for medical benefits claims, general liability, excess liability, auto liability, trunkline liability, errors and omissions, physical damage (equipment, buildings and contents) and workers compensation. Settled claims for the commercial insurance have not exceeded the amount of insurance coverage in any of the past 3 years.

REQUIRED SUPPLEMENTARY INFORMATION

CITY OF TAWAS CITY
Iosco County, Michigan

STATEMENT OF REVENUE, EXPENDITURES AND
 CHANGES IN FUND BALANCES - BUDGET AND ACTUAL
 GENERAL FUND
For the Year Ended June 30, 2004

	Original Budget	Final Amended Budget	Actual	Variance - Favorable (Unfavorable)
<u>Revenue</u>				
Current property taxes	\$ 698,000	\$ 720,000	\$ 731,365	\$ 11,365
Federal grants	0	0	3,143	3,143
State grants and revenue	234,000	234,000	217,049	(16,951)
Charges for services	268,189	246,189	296,641	50,452
Interest and rentals	75,001	75,001	102,287	27,286
Other revenue	50	50	481	431
Total revenue	<u>1,275,240</u>	<u>1,275,240</u>	<u>1,350,966</u>	<u>75,726</u>
<u>Expenditures</u>				
Current:				
General government	217,170	268,887	256,002	12,885
Public safety	314,262	318,269	319,809	(1,540)
Public works	242,512	381,421	358,724	22,697
Community and economic development	8,650	7,650	6,685	965
Recreation and cultural	107,450	112,792	85,742	27,050
Other	211,750	23,400	22,630	770
Capital outlay	53,988	57,708	51,879	5,829
Total expenditures	<u>1,155,782</u>	<u>1,170,127</u>	<u>1,101,471</u>	<u>68,656</u>
Excess of revenue over expenditures	<u>119,458</u>	<u>105,113</u>	<u>249,495</u>	<u>144,382</u>
Other Financing Sources (Uses):				
Operating transfers in	0	0	5	5
Operating transfers out	(79,220)	(79,220)	(80,658)	(1,438)
Transfers to component unit	<u>(120,000)</u>	<u>(120,000)</u>	<u>(120,000)</u>	<u>0</u>
Total other financing sources (uses)	<u>(199,220)</u>	<u>(199,220)</u>	<u>(200,653)</u>	<u>(1,433)</u>
Excess of revenue and other sources over (under) expenditures and other uses	<u>(79,762)</u>	<u>(94,107)</u>	<u>48,842</u>	<u>142,949</u>
Fund balances - beginning of year	<u>609,424</u>	<u>609,424</u>	<u>609,424</u>	<u>0</u>
Fund balances - end of year	<u>\$ 529,662</u>	<u>\$ 515,317</u>	<u>\$ 658,266</u>	<u>\$ 142,949</u>

CITY OF TAWAS CITY
Iosco County, Michigan

STATEMENT OF REVENUE, EXPENDITURES AND
 CHANGES IN FUND BALANCES - BUDGET AND ACTUAL
 MAJOR STREET FUND - SPECIAL REVENUE FUND
For the Year Ended June 30, 2004

	Original Budget	Final Amended Budget	Actual	Variance - Favorable (Unfavorable)
<u>Revenue</u>				
Federal grants	\$ 0	\$ 0	\$ 47,235	\$ 47,235
State grants and revenue	154,455	154,455	177,027	22,572
Interest and rentals	300	300	160	(140)
Other revenue	0	0	1,201	1,201
Total revenue	<u>154,755</u>	<u>154,755</u>	<u>225,623</u>	<u>70,868</u>
<u>Expenditures</u>				
Current:				
Public works	135,805	167,519	162,527	4,992
Capital outlay	<u>50,050</u>	<u>28,336</u>	<u>72,592</u>	<u>(44,256)</u>
Total expenditures	<u>185,855</u>	<u>195,855</u>	<u>235,119</u>	<u>(39,264)</u>
Excess of revenue over (under) expenditures	(31,100)	(41,100)	(9,496)	31,604
Fund balances - beginning of year	<u>64,353</u>	<u>64,353</u>	<u>64,353</u>	<u>0</u>
Fund balances - end of year	<u>\$ 33,253</u>	<u>\$ 23,253</u>	<u>\$ 54,857</u>	<u>\$ 31,604</u>

CITY OF TAWAS CITY
Iosco County, Michigan

STATEMENT OF REVENUE, EXPENDITURES AND
 CHANGES IN FUND BALANCES - BUDGET AND ACTUAL
 LOCAL STREET FUND - SPECIAL REVENUE FUND
For the Year Ended June 30, 2004

	Original Budget	Final Amended Budget	Actual	Variance - Favorable (Unfavorable)
<u>Revenue</u>				
State grants and revenue	\$ 50,375	\$ 50,375	\$ 49,200	\$ (1,175)
Interest and rentals	100	100	65	(35)
Total revenue	<u>50,475</u>	<u>50,475</u>	<u>49,265</u>	<u>(1,210)</u>
<u>Expenditures</u>				
Current:				
Public works	66,810	76,810	63,556	13,254
Capital outlay	23,140	23,140	22,341	799
Total expenditures	<u>89,950</u>	<u>99,950</u>	<u>85,897</u>	<u>14,053</u>
Excess of revenue over (under) expenditures	(39,475)	(49,475)	(36,632)	12,843
Other Financing Sources:				
Operating transfers in	<u>40,000</u>	<u>50,000</u>	<u>40,000</u>	<u>(10,000)</u>
Excess of revenue and other sources over expenditures	525	525	3,368	2,843
Fund balances - beginning of year	<u>34,383</u>	<u>34,383</u>	<u>34,383</u>	<u>0</u>
Fund balances - end of year	<u>\$ 34,908</u>	<u>\$ 34,908</u>	<u>\$ 37,751</u>	<u>\$ 2,843</u>

OTHER INFORMATION

CITY OF TAWAS CITY
Iosco County, Michigan

COMBINING BALANCE SHEET
 OTHER GOVERNMENTAL FUNDS
June 30, 2004

	Equipment Fund	Building Authority Fund	Cemetery Perpetual Care	Building Authority Debt Retirement Fund	Total Other Governmental Funds
<u>ASSETS</u>					
Cash and cash equivalents	\$ 107,947	\$ 63,386	\$ 2,264	\$ 10	\$ 173,607
Investments - real estate	0	0	2,570	0	2,570
Due from other funds	<u>1,438</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>1,438</u>
Total Assets	<u>\$ 109,385</u>	<u>\$ 63,386</u>	<u>\$ 4,834</u>	<u>\$ 10</u>	<u>\$ 177,615</u>
<u>LIABILITIES AND FUND EQUITY</u>					
Liabilities:					
Due to other funds	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 5</u>	<u>\$ 0</u>	<u>\$ 5</u>
<u>Fund Equity</u>					
Fund balances:					
Reserved for:					
Debt service	0	0	0	10	10
Perpetual care	0	0	4,829	0	4,829
Unreserved, reported in:					
Special revenue funds	<u>109,385</u>	<u>63,386</u>	<u>0</u>	<u>0</u>	<u>172,771</u>
Total fund equity	<u>109,385</u>	<u>63,386</u>	<u>4,829</u>	<u>10</u>	<u>177,610</u>
Total Liabilities and Fund Equity	<u>\$ 109,385</u>	<u>\$ 63,386</u>	<u>\$ 4,834</u>	<u>\$ 10</u>	<u>\$ 177,615</u>

CITY OF TAWAS CITY
Iosco County, Michigan

COMBINING STATEMENT OF REVENUE, EXPENDITURES AND CHANGES IN FUND BALANCES
 OTHER GOVERNMENTAL FUNDS
For the Year Ended June 30, 2004

	Equipment Fund	Building Authority Fund	Cemetery Perpetual Care	Building Authority Debt Retirement Fund	Total Other Governmental Funds
<u>Revenue</u>					
Interest and rentals	\$ 403	\$ 131	\$ 5	\$ 10,425	\$ 10,964
Other revenue	70	0	60	25	155
Total revenue	<u>473</u>	<u>131</u>	<u>65</u>	<u>10,450</u>	<u>11,119</u>
<u>Expenditures</u>					
Current:					
Other	487	0	0	18	505
Debt service:					
Principal	19,847	35,000	0	5,000	59,847
Interest and fiscal charges	9,373	19,143	0	5,425	33,941
Total expenditures	<u>29,707</u>	<u>54,143</u>	<u>0</u>	<u>10,443</u>	<u>94,293</u>
Excess of revenue over (under) expenditures	<u>(29,234)</u>	<u>(54,012)</u>	<u>65</u>	<u>7</u>	<u>(83,174)</u>
Other Financing Sources (Uses):					
Sale of fixed assets	2,200	0	0	0	2,200
Operating transfers in	58,158	0	0	0	58,158
Transfers from component unit	0	61,760	0	0	61,760
Operating transfers out	0	0	(5)	0	(5)
Total other financing sources (uses)	<u>60,358</u>	<u>61,760</u>	<u>(5)</u>	<u>0</u>	<u>122,113</u>
Excess of revenue and other sources over expenditures and other uses	31,124	7,748	60	7	38,939
Fund balances - beginning of year	<u>78,261</u>	<u>55,638</u>	<u>4,769</u>	<u>3</u>	<u>138,671</u>
Fund balances - end of year	<u>\$ 109,385</u>	<u>\$ 63,386</u>	<u>\$ 4,829</u>	<u>\$ 10</u>	<u>\$ 177,610</u>

CITY OF TAWAS CITY
Iosco County, Michigan

SUPPLEMENTAL INFORMATION FOR FARMERS HOME ADMINISTRATION
For the Year Ended June 30, 2004

1. Our audit was conducted in accordance with generally accepted auditing standards.
2. We have audited the basic financial statements of the City of Tawas City for the year ended June 30, 2004 and have issued our report thereon dated September 23, 2004. As part of our audit, we considered the internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure. However, we noted one matter involving the internal control structure and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants.

Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the City of Tawas City's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

As a result of limited staff, there exists a lack of segregation of duties, or compensating controls, with regard to the cash receipts and cash disbursements of the City of Tawas City.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, the reportable condition described above is believed to be a material weakness. We also noted other matters involving the internal control over financial reporting that we have reported to management of the City of Tawas City in a separate letter dated September 23, 2004.

This report is intended solely for the use of management and the Farmers Home Administration and should not be used for any other purpose.

3. The accounting records maintained by the City of Tawas City are satisfactory and we have no major recommendations for improvements.
4. The City's physical control of the assets is satisfactory.
5. The City is in financial compliance with the loan agreement. Certain reporting requirements will be met with issuance of this report.
6. The financial reports included in this audit report are in agreement with the accounting records of the City and no major or unusual adjustments were necessary.
7. Deposit of funds of the project are in financial institutions insured by the federal government.

CITY OF TAWAS CITY
Iosco County, Michigan

SUPPLEMENTAL INFORMATION FOR FARMERS HOME ADMINISTRATION
For the Year Ended June 30, 2004

8. The City of Tawas City has insurance coverage in the amount of:

Commercial Umbrella Package	\$ 2,000,000
Public Officials Policy	\$ 5,000,000
Automotive Policy	\$ 5,000,000
Building and Personal Property	\$ 2,622,456
General Liability	\$ 7,000,000

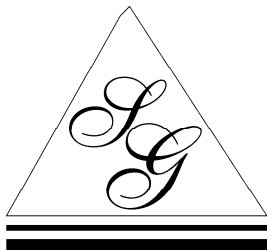
9. The City of Tawas City is exempt from federal income tax.

10. No unsatisfactory conditions were noted during the audit.

11. An aging of the accounts receivable as of June 30, 2004 is as follows:

	<u>Total</u>	<u>0-30</u>	<u>31-60</u>	<u>61-90</u>	<u>Over 90</u>
Customers:					
Water Fund	\$ 31,832	\$ 25,377	\$ 5,010	\$ 640	\$ 805
Sewer Fund	\$ 58,173	\$ 46,376	\$ 9,156	\$ 1,169	\$ 1,472

12. No other information is necessary for full disclosure.



Stephenson Gracik & Co., P.C.

Certified Public Accountants & Consultants

Alan J Stephenson, CPA
Gerald D Gracik Jr., CPA
James J Gracik, CPA
E. Thad Gray, CPA
Donald W. Brannan, CPA
Kyle E Troyer, CPA

Herman A Bertuleit, CPA

September 23, 2004

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Members of the City Council
City of Tawas City
Iosco County, Michigan

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Tawas City, as of and for the year ended June 30, 2004, which collectively comprise the City of Tawas City's basic financial statements and have issued our report thereon dated September 23, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the City of Tawas City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted one immaterial instance of noncompliance that we have reported to management of the City of Tawas City in a separate letter dated September 23, 2004.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Tawas City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted one matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the City of Tawas City's ability to record, process, summarize and report financial data consistent with the assertions of management in the general purpose financial statements. The reportable condition is described below.

Separation of Duties in the Performance of Functions

The present system of internal accounting controls does not provide for separation of duties in the performance of functions. In our opinion, the system is adequate to account for the financial activity of the City but could be strengthened by a few minor changes in the personnel assigned to perform certain functions.

We recommend that the cash receipts and cash disbursements functions be handled by different individuals. Cash receiving should be centralized in a person without authority to sign checks and without access to noncash accounting records and not involved in reconciling bank accounts. A different person should prepare checks and reconcile the bank accounts.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would

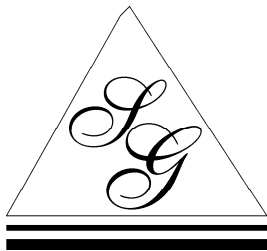
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Members of the City Council
City of Tawas City
September 23, 2004
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not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above to be a material weakness.

This report is intended solely for the information and use of management, City Council and the Michigan Department of Treasury and is not intended to be and should not be used by anyone other than these specified parties.

Stephenson, Grault & Co., P.C.



Stephenson Gracik & Co., P.C.

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September 23, 2004

Members of the City Council
City of Tawas City
Iosco, Michigan

Dear Council Members:

We have audited the financial statements of the City of Tawas City for the year ended June 30, 2004, and have issued our report thereon dated September 23, 2004. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under U.S. Generally Accepted Auditing Standards and Government Auditing Standards

As stated in our engagement letter dated May 19, 2004, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the basic financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered the City of Tawas City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting.

As part of obtaining reasonable assurance about whether the City of Tawas City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City of Tawas City are described in Note 1 to the financial statements. As described in Note 2 to the financial statements, the City changed accounting policies as a result of adopting Statement of Governmental Accounting Standards (GASB Statements) No. 34, 33 and 38, in the year ended June 30, 2004. We noted no transactions entered into by the City of Tawas City during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the basic financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the City of Tawas City's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the City of Tawas City, either individually or in the aggregate, indicate matters that could have a significant effect on the City of Tawas City's financial reporting process.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the general purpose financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City of Tawas City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

Additional Information

As a result of our study and evaluation of the internal controls as described in the third paragraph, certain matters came to our attention upon which we would like to comment and offer the following recommendations:

Separation of Duties in the Performance of Functions

The present system of internal control does not provide for separation of duties in the performance of functions. In our opinion, the system is adequate for the financial activity of the City but could be strengthened by a few minor changes in the personnel assigned to perform cash functions.

We recommend that the cash receipts and cash disbursements functions be handled by different individuals. Cash receiving should be centralized in a person without authority to sign checks and without access to noncash accounting records and not involved in reconciling bank accounts. A different person should prepare checks and reconcile the bank accounts.

Budget Control

We noted that the City's General and Special Revenue Funds included expenditures in some functions that exceeded appropriated amounts. We recommend that the City Council continue to amend the budgets for all funds as needed and take into consideration year end accounts payable and recurring year end audit adjustments.

We wish to express our appreciation for the cooperation and courtesies extended our staff by management and employees of the City.

This information is intended solely for the use of management, the City Council and the Michigan Department of Treasury and is not intended to be and should not be used by anyone other than these specified parties.

Stephenson, Grain & Co., P.C.